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IN THE

Supreme Court of the United States

October Term, 1982

MARINE MIDLAND BANK,

Petitioner,

v.

THE UNITED STATES,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR FEDERAL CIRCUIT

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QUESTIONS PRESENTED

1. Has a compensable "taking" occurred when the Government through its title-vesting clause, contained in over 10,000 contracts nationally, takes property subject to a security interest validly perfected under state law?
2. In establishing the relative priority of competing federal and private interests in property, is uniform commercial state law the appropriate federal rule to be applied?
3. Given that state law is the appropriate federal rule to be applied in such cases, under Virginia law is Marine Midland Bank's properly perfected security interest paramount to the Government's claimed interest?

PARTIES TO THE PROCEEDING

The parties to this proceeding are Marine Midland Bank and the United States. After the original institution of these proceedings, Marine Midland Bank converted from a state banking corporation to a national banking association, changing its name to Marine Midland Bank, N.A.[1]

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[1] Petitioner-Plaintiff, Marine Midland Bank, N.A., a national banking association, is a wholly-owned subsidiary of Marine Midland Banks, Inc., a Delaware corporation, which is in turn 51 percent owned by The Hongkong and Shanghai Banking Corporation, a Hong Kong Corporation. Included in Part C of the Appendix are a list of the subsidiaries of Marine Midland Banks, Inc. and a list of the subsidiaries and related interests of The Hongkong and Shanghai Banking Corporation.

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OPINION BELOW

The opinion of the Court of Claims (App., Part A, infra) is reported at 231 Ct. Cl. ____ (1982), 687 F.2d 395 (Ct. Cl. 1982).[2]

GROUNDS FOR JURISDICTION

The date of judgment sought to be reviewed is August 25, 1982. Marine Midland Bank's Motion for Rehearing was denied on September 24, 1982.[3] (See App., Part A, infra.) The jurisdictional statutory provision is 28 U.S.C. § 1255.

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[2] The slip opinion of the Court of Claims is reproduced in the Appendix, Part A, infra; citation is made to the unofficial report.

[3] The Order of the Court of Claims denying the Motion for Rehearing is reproduced in the Appendix, Part A, infra.

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS

A. U.S. Const. amend. V: "[n]or shall private property be taken for public use, without just compensation."

B. Statutes[4]: 10 U.S.C. § 2307, 28 U.S.C. § 1491, 31 U.S.C. § 529; Va. Code §§ 8.1-201(44), 8.2-401(2), 8.2-402, 8.2-501, 8.2-502, 8.9-107, 8.9-204, 8.9-301, 8.9-312, 11-1, 55-95, 55-96.

C. Regulations: 32 C.F.R. §§ 163.1, 163.2, 163.9, 163.11, 163.24, 163.26, 163.28, 163.79-2, 163.94.

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[4] The pertinent text of the statutes and regulations cited in this petition are reproduced in the Appendix, Part B, infra.

IN THE

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MARINE MIDLAND BANK,

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PETITION FOR A WRIT OR CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR FEDERAL CIRCUIT

STATEMENT OF THE CASE

This case involves a dispute with far-reaching implications nationally between Marine Midland Bank, Buffalo, New York (Marine) and the United States (the Government or the United States) as

to their respective interests in certain property of Bond Trailer Division, Inc. (Bond), consisting of its inventory of materials, supplies, work in progress, and similar property (the Collateral). This action was commenced as a detinue proceeding in the Circuit Court of Rockingham County, Virginia. Marine sought to recover the Collateral pursuant to certain security agreements executed by Bond (the Security Agreements), dated and executed December 20, 1977, to secure its guaranty (the Guaranty) of notes originally aggregating $1,700,000 (the Notes) executed by a related corporation, United Manufacturing Co. (United). United defaulted under its obligations under the Notes and demand was made by Marine upon Bond for payment pursuant to the Guaranty. Upon Bond's failure to satisfy the Guaranty and its refusal to voluntarily

deliver the Collateral to Marine, Marine instituted these proceedings on May 18, 1979 in the Rockingham County Circuit Court to obtain physical possession of the Collateral. On June 15, 1979, the United States filed its motion to intervene in the state court proceedings, claiming title to certain portions of the Collateral under the Government's "Progress Payment Clause for Small Business Concerns," 32 C.F.R. § 163.79-2 (alternatively referred to as the "title-vesting clause"). The case then was removed to the United States District Court for the Western District of Virginia.

Subsequently, Bond filed a petition in bankruptcy in the Bankruptcy Court for the Western District of Virginia. In those proceedings, all the property of Bond not claimed by the Government was sold and the proceeds less certain

expenses were paid to Marine. Determining that there was no equity in the bankrupt's estate, the property claimed by the Government and Marine was abandoned by the Bankruptcy Court.

Prior to the abandonment of the property from the bankruptcy proceeding, the Government and Marine agreed that the value of the Collateral in dispute, located in Rockingham County, Virginia, was $250,000. To achieve the best utilization of these materials, the parties agreed that the Government could take possession of these items subject to payment to Marine of the $250,000, should it ultimately be judicially determined that Marine's security interest was paramount to the asserted interest of the Government.

The proceedings in the United States District Court, held in abeyance pending the outcome of the bankruptcy

proceedings, were reopened upon the abandonment of the Collateral from the Bankruptcy Court. This case came before the Court of Claims under 28 U.S.C. § 1491 upon a transfer from the United States District Court for the Western District of Virginia, pursuant to an order entered by that court on April 27, 1981. Marine then filed an amended petition in the Court of Claims, requesting an award of $250,000 plus interest for the Government's taking of property which was subject to the paramount lien of Marine. Bond has never made an appearance in the proceedings in state court, the district court or the Court of Claims.

The Government's claim to the Collateral arises out of three contracts between Bond and the Government dated June 30, 1976, March 3, 1978, and May 9, 1978 (the Government Contracts). In the

case of the contracts effective June 30, 1976 and March 3, 1978, a title-vesting clause was included in its original bid solicitation. In the contract dated May 9, 1978, the clause was subsequently added to the contract by amendment dated September 19, 1978. Each of these Government Contracts involves the purchase of cargo or munitions trailers built by Bond for use by the Air Force or the Navy. The trailers were to be manufactured according to Government specifications, and Bond was to be paid periodically during the course of the contract on the basis of 85% of costs approved by the Government, with the retainage to be paid on the completion of each contract. These payments were to be made pursuant to the Government's title-vesting clause. In addition to providing for financing to Bond during its manufacture of these trailers, this

clause also contained provisions purporting to transfer title to goods to the Government. The pertinent provisions of this contract clause read as follows:

> (d) Title. Immediately, upon the date of this contract, title to all parts; materials; inventories; work in process . . . theretofore acquired or produced by the Contractor and allocable [allocated][5] or properly chargeable to this contract under sound and generally accepted accounting principles and practices shall forthwith vest in the Government; and title to all like property thereafter acquired or produced by the Contractor and allocated or properly chargeable to this contract as

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[5] There exists some question about whether the term "allocable" or allocated" was used in the applicable regulation. See 32 C.F.R. § 163.79-2 infra. The Court of Claims, however, in its opinion, quoted from the Code of Federal Regulations, which utilized the term "allocated." See Marine Midland Bank v. United States, 687 F.2d 395, 397 (Ct. Cl. 1982).

> aforesaid shall forthwith vest in the Government upon said acquisition, production, or allocation . . . .

32 C.F.R. § 163.79-2 (Defense Contract Financing Regulations)(formerly § 7-104.35, Armed Services Procurement Regulations).

Bond, a Virginia corporation, operated its manufacturing facility at its principal place of business in Rockingham County, Virginia. Its business was not limited to government contracting work and its facilities were open to the public. All of the Collateral sought by Marine in these proceedings was located in Rockingham County, Virginia, at the time of the institution of these proceedings.

Marine filed financing statements evidencing its security interest in the Collateral with the Virginia State Corporation Commission on January 8,

1978, and with the Circuit Court of Rockingham County on January 9, 1978. While Marine knew that Bond manufactured items for the Government, it was not aware that the Government Contracts contained the "title-vesting clause." It is undisputed that neither the Government Contracts nor any financing statements relating to these contracts were ever recorded in Virginia by the Government or Bond.

On cross motions for summary judgment, the Court of Claims granted the Government's motion, holding that the Government's claim under its hidden title-vesting clause took priority over Marine's properly perfected security interests in the Collateral. Rather than adopting uniform state law as the federal priority rule, the Court of Claims fashioned a unique rule which validates secret liens and which will

have enormous, disruptive effect on commerce nationwide. Marine Midland Bank v. United States, 687 F.2d 395, 404 (Ct. Cl. 1982).

BASIS FOR FEDERAL JURISDICTION

The basis for jurisdiction in the Court of Claims was 28 U.S.C. § 1491 which provides:

> The Court of Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort . . . .

REASONS FOR GRANTING WRIT OF CERTIORARI

A. Summary

A writ of certiorari should be granted because (1) the Court of Claims has reached a decision inconsistent with

the decision of this Court in Kimbell Foods, Inc. v. United States, 440 U.S. 715 (1979); (2) the Court of Claims and the Tenth Circuit Court of Appeals have reached opposite results as to the applicability of state law in resolving competing Government and private interests in property; (3) the decision of the Court of Claims, which affects more than 10,000 Government contracts in which the title-vesting clause is found[6], will result in recurring problems of national significance in

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[6] This Court previously has granted certiorari in cases from the Court of Claims when, as in this case, important questions of construction of Government contracts were presented. See, e.g., United States v. Utah Constr. & Min. Co., 384 U.S. 394 (1966); United States v. Blair, 321 U.S. 730 (1943).

that it validates secret liens upon collateral and thereby undermines the expectations of creditors who justifiably rely on state law to obtain superior liens and significantly limits the reliability of the Uniform Commercial Code's notice-filing system which plays a fundamental role in commercial dealings; and (4) the decision of the Court of Claims thwarts, rather than effectuates, the program adopted by Congress for the financing of small government contractors.

B. Governing Law

To determine the rights of Marine and the United States in this case, the pivotal inquiries are "whether federal or state law governs the controversies; and second, if federal law applies, whether this Court should fashion a

uniform priority rule or incorporate state commercial law." Kimbell Foods, Inc. v. United States, 440 U.S. 715, 718. The Court of Claims chose to fashion a unique federal rule rather than adopting uniform state law as the federal priority rule. In so doing, it failed to follow the three principles set forth by this Court in Kimbell Foods for determining, in the absence of specific congressional guidance, whether to adopt state law or to fashion a uniform federal rule: (1) the need for uniformity; (2) the likelihood of frustrating specific federal objectives; and (3) the potential for disruption of commercial relationships. 440 U.S. at 728-29.

In Government procurement law, there exists a general proscription against the Government making advance payments, partial payments, progress

payments and other payments to contractors prior to completion of the work. 31 U.S.C. § 529. These types of payments are separate and distinct. "Advance payments" are made to a contractor prior to complete performance and are not measured by performance. 32 C.F.R. § 163.9. "Progress payments," the type of payment involved in this case, are made as the work progresses on a contract, being based on the costs incurred or the percentage of completion at a particular time. 32 C.F.R. § 163.11.

Congress, in 10 U.S.C. § 2307, has made an exception to the general prohibition against payments being made before Government work is completed. This statutory exception provides for federal lien supremacy only in the case of "advance" payments, which are to be made only if the contractor gives

security in a form such as a lien in favor of the United States. If such a lien is given, it then will be superior to any other liens. The statute is silent as to how these liens are to be perfected or notice given to the public of their existence. With respect to "progress" payments, the type of payment involved in this case, it is clear that Congress has not established either liens or their priority. This Court then must fashion the appropriate rules of law to determine the analytical framework for the resolution of the competing interests of the Government, and lenders and suppliers of Government contractors.

C. Need for Uniformity and the Objectives of the Federal Program

To determine whether federal law requires a unique federal rule of

priority, this Court has stated that the particular federal program must be examined to "determine whether application of state law would frustrate specific objectives of the federal programs." Kimbell Foods, Inc. v. United States, 440 U.S. at 728. The federal program in this case involves the procurement of supplies, material and equipment for the national defense and the financing of small businesses; there can be little question that these activities involve important national and federal interests. Yet, this factor does not necessarily require nationwide standards favoring the Government, especially when to do so would dramatically disrupt nationwide commercial relationships predicated on uniform state law. As this Court in Kimbell Foods quoted Judge Friendly with approval:

> When the states have gone so far in achieving the desirable goal of a uniform law governing commercial transactions, it would be a distinct disservice to insist on a different one for the segment of commerce, important but still small in relation to the total, consisting of transactions with the United States.

440 U.S. at 732.

It is fundamental in this case that the goals of the Government's title-vesting clause be reviewed and a determination made of whether the adoption of state law realistically can be expected to impinge on the Government's ability to supply its national defense. Contrary to the arguments made by the Government in the Court of Claims, the adoption of state law would not result in a hindrance to the Government's procurement policy, as the Tenth Circuit recognized in In re Murdock Mach. & Eng'r Co., 620 F.2d 767, 772 (10th Cir. 1980). In Murdock, the Tenth

Circuit adopted the state commercial code, which "controls the mainstream of business life in this country," as the rule of decision and held that a vendor of goods to a government contractor retained the right of stoppage of goods in transit upon learning of the contractor's insolvency. Despite the presence of a title-vesting clause in the contract involved in Murdock, the court held that the vendor was entitled to the proceeds upon the sale of the goods.

The legislation giving rise to the title-vesting clause, 10 U.S.C. § 2307, was not designed primarily to facilitate defense procurement. Rather, as its legislative history clearly indicates, the intended beneficiaries of 10 U.S.C. § 2307 are small businesses. Upon the adoption of 10 U.S.C. § 2307, the Senate concluded:

> The bill would also modernize the existing statutory provisions of law, relating to advance and progress payments, and authorize the limitation of advance and progress payments on any procurement warranting such action to small business concerns. These proposals will improve the ability of small business concerns to compete for Government awards without any increase in cost to the Government. As a result, the Government will achieve the benefits flowing from increased competition and from the establishment of new sources of supply with the attendant economy in procurement costs and improvement in the Nation's security.
>
> [The bill] would permit the making of advance and progress payments to suppliers holding contracts with the Government in such manner as would enable small business concerns to participate in furnishing certain types of supplies and services which heretofore were only obtainable from the large or financially strong concerns.

S. Rep. No. 2201, 85th Cong., 2d Sess., reprinted in [1958] U.S. Code Cong. & Ad. News 4021, 4023 (emphasis added).

The Administrator of the General Services Administration likewise had these comments on this legislation:

> It is believed that the draft bill will help achieve the objectives of the Cabinet Committee on Small Businesses -- to eliminate needless inconsistencies, to simplify, and to remove any inequities, in procurement procedures of Government agencies, with a view to facilitating participation of small businesses in work on Government contracts.

Id. at 4029 (emphasis added). These and other comments filed with respect to this legislation show that the Congress sought to support small businesses. Id., et. seq.

The regulations adopted pursuant to 10 U.S.C. § 2307 do not provide the Defense Department with emergency procurement powers, but rather are designed to facilitate the use of progress payments to aid firms whose

capital or financial condition limits their ability to bid and obtain Government contracts. See 32 C.F.R. § 163.2. Simply stated, the Government, if it chose, could refuse to pay for any of its goods until delivery. This action obviously would restrict the number of businesses which could compete for Government work to those which could finance internally or through conventional financing sources, effectively thwarting the main purpose of the legislation. Clearly, a decision of this Court to apply uniform state law, as did the Tenth Circuit in Murdock, will not restrict the Government's ability to appropriate property in a national emergency. It is undisputed that the Government may take property to accomplish the common defense, however, its authority to do so is subject to the

right of persons under the Fifth Amendment to receive just compensation for such takings.

The Court of Claims correctly found that the progress payments in this case constituted a lending activity by the Government. 687 F.2d at 398-99. The Defense Contract Financing Regulations, 32 C.F.R. § 163.1 et. seq., clearly establish the Defense Department's role as a lender. As vividly demonstrated by its own regulations, the Government's activities in this context are closely akin to those of the Small Business Administration (SBA) and the Farmers Home Administration (FHA), the federal agencies involved in Kimbell Foods, as a financier of small businesses. See 32 C.F.R. § 163.24 (requiring the examination of the contractor's financial capabilities); 32 C.F.R. § 163.26

(requiring procurement offices to be staffed with financial credit analysts); 32 C.F.R. § 163.28 (requiring review of essential financial information, balance sheets, profit and loss statements, compensation agreements, dividends, and cash forecasts). As the Court of Claims noted:

> The goal of the system, as articulated in Subpart B -- 'Basic Policies' is '[t]he providing of funds for payment in expenses of performance of contracts [as] an essential element of defense production.' Section 163.18. Further, 'Prudent contract financing supports procurement and production * * * by providing necessary funds to supplement other funds available to contractors for contract performance.' Id. Recognizing the risks inherent in loaning money, however, the regulations provide that such financing must be designed to minimize monetary loss to the government. Section 163.19. The various types of advance payments are granted only in a set order of preference, all of which succeed private financing on reasonable terms,

> section 163.22, and financing is not allowed at all unless the contractor appears properly creditworthy.

Marine Midland Bank v. United States, 687 F.2d at 398. While the Court of Claims concluded that a uniform federal rule was required, it failed to distinguish between a program which, in encouraging small business participation, establishes uniform credit criteria and the more mechanical aspect of commercial lending such as the verification of collateral and the protection of the loan.

In Kimbell Foods, this Court also dealt with nationwide lending programs designed to accomplish objectives beyond those of merely lending money: the fostering of small business and assistance to farmers. In both instances, similar meticulous credit detail was obtained prior to the issuance of the

loans. 440 U.S. at 732. As with the SBA and FHA, the Defense Department's own regulations belie the assertion that a unique federal rule of priority is required. In addition to the close credit scrutiny provided by the regulations described above, the existing regulations instruct that "care should be taken to assure, to the extent necessary, that the title to the Government will be free of all encumbrances. The procedure will in this respect necessarily vary with the particular circumstances of individual cases." 32 C.F.R. § 163.94. Once again, this Court's holding in Kimbell Foods is instructive:

> Because each application [for credit] currently receives individual scrutiny, the agencies can readily adjust loan transactions to reflect state priority rules, just as they consider other factual and legal matters before

> disbursing Government funds . . . . Since there is no indication that variant state priority schemes would burden current methods of loan processing, we conclude that considerations of administrative convenience do not warrant adoption of a uniform federal law.

440 U.S. at 733.

For these reasons, Marine submits that the Court of Claims has misapplied the concepts of uniformity set forth by this Court in Kimbell Foods and also in United States v. Yazell, 382 U.S. 341, 344 (1966). Nothing is set forth in the opinion below to indicate how the Government's program of fostering small business participation in the defense contracting sector would be frustrated by adopting uniform state law as the federal rule in the determination of the rights of the Government and those other parties which might extend credit or do

business with such contractors. As the Court of Appeals found in Murdock:

> The state commercial codes do not frustrate the objectives of government procurement programs . . . . We recognize that the United States must have the means to acquire materials necessary for defense and other government purposes. Nevertheless, we believe the government is capable of protecting itself within the framework of state commercial law.

In re Murdock Mach. & Eng. Co., 620 F.2d 767, 772 (10th Cir. 1980). Once again this Court is asked not "to override intricate state laws of general applicability on which private citizens base their daily commercial transactions." Kimbell Foods, 440 U.S. at 729.

In the context of goods and inventory financing, the nationwide adoption of the Uniform Commercial Code (U.C.C.) provides reasonably standardized rules for the protection of the Government and

other creditors of contractors with the Government. The existing regulations of the Government should be read to require minimum standards of search and verification of liens or outstanding security interests. Centralized filing and recording of financing statements are done every day by creditors across the country, with a great number of creditors operating throughout the many states. While there might be involved some additional work, it is something which this country's other federal lenders, the SBA and FHA, do daily without frustration of their specific objectives of fostering and aiding small businesses and farmers.

D. Disruption of Nationwide Commerce

The decision by the Court of Claims eliminates the certainty lenders nationwide customarily have if their borrowers

should ever deal with the Government and could cause substantial disruptions in established commercial practices. It permits the "dealing [of] Government 'wild cards' to businesses at random," found unjust by the Tenth Circuit in In re Murdock Mach. & Eng'r Co., 620 F.2d 767, 772 (10th Cir. 1980):

> Many of the reasons which support the holding in Kimbell Foods persuade us that we must adopt state law as the rule of decision in this case. State commercial codes control the mainstream of business life in this country. These codified rights and duties allow business to work within the framework of a settled, predictable environment. Thus, businessmen reasonably rely on the availability of those rights and duties unless otherwise agreed. [citation omitted].
>
> * * *
>
> In our view, if the government is allowed greater rights in the marketplace than others, then in every sale, including those between private parties, it becomes . . . relevant, and perhaps

> critical, to probe whether the Government is somehow secretly involved. Once government involvement is discovered, the peculiar legal effect of such involvement . . . must be ascertained . . . . Mindful of the burdens of time and expense such investigations would impose on our nation's commerce, and the injustice which would result by dealing government 'wild cards' to businessmen at random, we are not inclined to create a special commercial law for the government's benefit.

Id. at 772. In such an environment of hidden Government liens, lenders to small businesses contracting with the Government must make credit decisions which could easily result in the curtailment of credit to such businesses. This consequence is clearly an anomaly in light of the fact that the current progress payment legislation was designed to help small businesses have greater access to the government contracting business. [1958] U.S. Code

Cong. & Admin. News, supra at 4021, 4023, 4029.

With readily available reporting services outlining the U.C.C. in each state, and the relative uniform nature of the U.C.C., the Government's burden is not one it failed to recognize when its regulations are examined. The Government's own regulations presently call for the contracting officers to verify the existence of prior liens to insure the protection of the Government. See 32 C.F.R. § 163.94. This requirement is very similar to the SBA Manual's instructions cited by this Court in Kimbell Foods. As this Court noted:

> Thus, the agencies' own operating practices belie their assertion that a federal rule of priority is needed to avoid the administrative burden created by disparate state commercial rules.

440 U.S. at 732.

The Court of Claims, in adopting a unique federal rule of priority for unrecorded liens in favor of the Government in this case, did so largely upon the assumption that the interest of the Government constituted a "purchase money security interest" so that the prior creditors of Bond were not adversely affected by such a rule. This assumption clearly is erroneous upon examination.

In this case, progress payments were made to Bond at a rate of eighty-five percent (85%) of the value of the work completed as its work on the Government contracts progressed. Thus, materials had to be purchased and manufacturing begun before the Government would advance any funds to Bond. In the opinion of the Court of Claims, this type of financing "increases the value of Bond's assets [so that] it was

fair and appropriate that the government should be given priority with respect to the additional value its own monetary advances created." 687 F.2d at 407 (Friedman, C. J., concurring). In addition, the Court of Claims believed this rule followed the "modern practice of giving priority to purchase money interests . . . ." 687 F.2d at 404.

The U.C.C. recognizes two basic types of purchase money security interests. The first type results in a debtor receiving property subject to a lien in favor of his seller. See, e.g., Va. Code (U.C.C.) § 8.9-107(a). In this context, the creditors of the buyer are arguably no worse off. The debtor has acquired additional property, although it is subject to liens in favor of the seller. See also Va. Code § 8.2-402. The second category of purchase money

security interests involves those taken by a person who makes advances or incurs obligations or gives value to enable a debtor to acquire collateral if such value is in fact so used. See, e.g., Va. Code (U.C.C.) § 8.9-107(b). In this case, if a lender advances funds and those funds are used to purchase inventory, then the lien securing those advances constitutes a purchase money security interest. As in the first case, the assets of the debtor have been increased and certain protections are afforded that lender.

In this case, however, the Government's interest is not a purchase money security interest. Funds were not advanced to Bonú to acquire additional goods; they were advanced to be applied against eight-five percent (85%) of the value of the goods in place. In reali-

ty, they constituted working capital, and the Government's interest constituted a floating lien on inventory.

In light of these considerations, the holding by the Court of Claims is neither fair nor appropriate, and the modern trend, as evidenced by the U.C.C., does not give unrecorded and subordinate security interests priority even if they are purchase money security interests, except in very limited circumstances. See, e.g., Va. Code (U.C.C.) §§ 8.9-301, 8.9-312. The lender who makes advances or extends credit against a floating lien is often the one who already has put value into the goods which the purchaser ultimately buys. In these Government contracts, payments would not occur until after the Government verified and approved the costs incurred for a particular con-

tract. See 32 C.F.R. § 163.79-2; Marine Midland Bank v. United States, 687 F.2d at 397. By the very nature of the process, the lender providing operating capital to a business could well have its funds disbursed to the contractor in advance of the Government's payments in order to provide funds for early payment discounts from the Contractor's vendors or to supply operating capital, only to have its security impaired by the unrecorded Government contracts. While the Court of Claims suggests that this could be resolved by the lender asking the borrowers whether they contract with the Government, it would provide little comfort or protection to a lender who would receive a negative or fraudulent response when the loan is made or application submitted and then have its customer contract with the Government.

Under the holding of the Court of Claims, it follows that a prudent, secured lender loses the effectiveness of its lien to the subsequent, undisclosed lien of the Government. To avoid this very problem, the U.C.C. has established clearly defined rules which provide protection to inventory financiers and purchase money security interests. See, e.g., Va. Code (U.C.C.) § 8.9-301(2).

In this case, there are two creditors both extending credit against the inventory of Bond. The Virginia U.C.C., as most other states, has addressed this problem and created uniform rules for the protection of all parties. Following the first-to-file and notice concepts of the U.C.C., if the Government's interest is held to be a floating lien on inventory, it is subordinate to a

prior perfected security interest because of its failure to take the simple step of filing a financing statement. See, e.g., Va. Code (U.C.C.) § 8.9-301. Even if the Court finds that the Government's interest is a purchase money security interest, it has failed to avail itself of the limited protection afforded such creditors. See, e.g., Va. Code (U.C.C.) § 8.9-312(3).

Despite the reasoning of the Court of Claims, this case creates the potential for tremendous harm to creditors of Government contractors. With unrecorded liens and title-passing provisions purporting to interject in over 10,000 contracts nationally the Government's interest in property at a very early stage, how will other creditors, secured and unsecured, know whether the goods or inventories of the contractor are his or

someone else's? The very disruption of established commercial practices recognized by Kimbell Foods would result:

> Creditors who justifiably rely on state law to obtain superior liens would have their expectations thwarted whenever a federal contractual security interest suddenly appeared and took precedence.

440 U.S. at 739 & n. 42.

E. The Application of State Law: Lien and Title Theories

Given that uniform state law such as the Virginia U.C.C. should be adopted as the federal rule, the relative rights of Marine and the United States in this particular case must be determined. Clearly, it is the law of Virginia which should control, as Virginia is the state in which Bond conducted its business and in which the Collateral was located. Central to this analysis is Marine's position that, whether the title-vesting provisions are construed to pass title

or to create a lien, Marine's security interest arose prior to either event, and the taking of property subject to Marine's lien properly perfected under Virginia law constitutes a compensable taking under this Court's decision in Armstrong v. United States, 364 U.S. 40 (1960); accord, Aetna Cas. & Surety Co. v. United States, 655 F.2d 1047, 1057 (Ct. Cl. 1981).

The Court of Claims correctly interpreted the effect of the title-vesting clause and the regulatory scheme under which it was issued to create a lien, rather than providing for the passing of title. The substantial elements of ownership remained with Bond: possession, risk of loss, excess property, etc. 687 F.2d at 399. Once the transaction is properly characterized as the creation of a lien for

the Government to secure the performance of Bond, the relative priorities of the competing liens of Marine and the United States must be ascertained.

As indicated, Congress has not determined to make the lien in favor of the United States superior to any state-created or authorized liens. Thus, with no congressional mandate of priority, state law should be applied. As the United States failed to perfect its lien under the Virginia U.C.C., its rights are subordinate to a prior perfected security interest in favor of Marine. Va. Code (U.C.C.) § 8.9-301. While there are steps which the Government could have taken to protect its interests, such as filing and notifying prior inventory lienholders, Va. Code (U.C.C.) § 8.9-312, it elected not to do so. When the Government took possession

of the Collateral, therefore, it was subject to the lien in favor of Marine and it is required to pay to Marine the value of its Collateral, $250,000.00.

While the Court of Claims correctly concluded that the interest of the Government was a lien and not a transfer of title, the result does not change even if the title-vesting clause were construed to transfer title rather than create a lien. If title passed to the Government, the inquiry then must be focused on when title passed and whether Marine's security interest was perfected at the time of passage. To determine exactly when title passed, the specific contract language relied upon by the Government is important:

> (d) Title. Immediately, upon the date of this contract, title to all parts . . . theretofore acquired or produced by the Contractor and

> allocable [allocated][7] or properly chargeable to this contract under sound and generally accepted accounting principles and practices shall forthwith vest in the Government; and title to all like property thereafter acquired or produced by the Contractor and allocated or properly chargeable to this contract as aforesaid shall forthwith vest in the Government upon said acquisition, production, or allocation . . . .

32 C.F.R. § 163.79-2.

The title-vesting clause makes it quite clear that the vesting of title is broken down between those goods on hand at the time of the execution of the contract and those acquired afterwards. With regard to the former, title vests upon the allocation to the particular contract upon the date of the contract. As to property "thereafter acquired,"

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[7] See n. 5 supra at p. 7.

title passes after the acquisition of property "allocable" to the contract. While the current regulations use the word "allocated," instead of the word "allocable,"[8] a matter of substance, Marine submits that for timing and priority purposes, the result would be the same. The title-vesting clause clearly contemplates an affirmative act of acquiring goods which, if already owned at the time of the contract, must then be allocated to the particular contract. For goods not in place on the execution of the contract, they must be of a character allocable to the contract and must be acquired by Bond. Upon such acquisition, title "shall forthwith vest" in the Government.

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[8] See n. 5 supra at p. 7.

Under the Virginia U.C.C., the security interest of Marine attached prior to the time the Government acquired title and even prior to Bond acquiring title. Marine's security interest in the Collateral attached upon the occurrence of three events: when Bond signed the security agreements; when "value" had been given by Marine; and when Bond had rights in the Collateral. Va. Code (U.C.C.) § 8.9-204. The actual passage of title need not have occurred prior to the attachment of Marine's security interest. In this case, the security agreements unquestionably were signed and Marine gave "value" when it extended credit to United. Va. Code (U.C.C.) § 8.1-201(44).

Contrary to the purported passing of title to the Government, which could

not occur until Bond itself acquired title, the floating inventory lien under the Virginia U.C.C. attaches not upon acquisition of the goods by the debtor, but when it has "rights" in the Collateral. This event occurs as early as when the debtor's vendor has "identified" the goods which the debtor ordered. See Va. Code (U.C.C.) §§ 8.2-501, 502. In addition, Bond's rights in the Collateral arose when title was transferred by delivery, Va. Code (U.C.C.) § 8.2-401(2), or shipment, Va. Code (U.C.C.) § 8.2-401(2)(a). Upon the happening of any of these events, which of necessity preceded the actual transfer of title to the Government, Marine's security interest attached. As this preceded the passage of title to the Government, this Court's decision in Armstrong v. United States, 364 U.S. 40

(1960) requires that Marine's interest be protected under the Fifth Amendment and, while Marine cannot stop the Government's obtaining possession of the Collateral, Marine is entitled to the value of its property interest, which in this case exceeded the value of the Collateral of $250,000.00.

Not only is Marine entitled to recover under the above analysis, it is also entitled to recover by reason of the failure of the Government to record either a financing statement or a bill of sale or contract with respect to the Collateral. Under Virginia law, as in other states, when a buyer permits the seller to retain possession of the goods and chattels, that contract is void as to purchasers for value of those goods without notice of the claim and to creditors (Va. Code § 11-1), unless it

is recorded or a security interest is perfected under the U.C.C. as adopted in the state. See Va. Code § 55-95, 55-96.

The Government has admitted that it never recorded financing statements or the Government contracts. It is also clear that it purported to purchase goods from Bond while leaving those goods in Bond's hands. Under Virginia law, therefore, Marine's interest is paramount to that of the Government's, and there has been a compensable taking of Marine's property by the Government.

Certainly the policy behind such pervasive state law is clear. Contractors with the Government may carry substantial inventories of supplies, parts, and work in progress, not all of which may be readily discernible to be used exclusively for Government contracts. Contractors

holding such property may mislead the public at large as to the nature of their assets. Suppliers and creditors customarily extend credit partly on the assumption that these supplies and inventories will be available to satisfy their claims in the event of the insolvency of the contractor. To avoid a possible fraud upon such creditors and suppliers, Virginia law (as most states) requires the simple filing of notices to the public either in the form of a lien or, if title is transferred, in the form of a bill of sale. Thus, a record search by the diligent creditor allows it to proceed with certain expectations as to the contractor's assets.

CONCLUSION

The Tenth Circuit, in the case of In re Murdock Mach. & Eng'r. Co., 620

F.2d 767 (10th Cir. 1980), correctly evaluated the risks of these "hidden title" clauses used by the Government and their impact on nationwide commercial practices. In doing so, its balancing of the factors required in Kimbell Foods in favor of requiring the Defense Department's procurement activities to comport with requirements of uniform state law are more consistent with Kimbell Foods than the holding of the Court of Claims below. The considerations underlying this Court's decision in Kimbell Foods and the Tenth Circuit's decision in Murdock are strikingly apposite to this case. First, state law, and in particular, state uniform commercial codes, provide the appropriate rules of decision. Second, the Government should not be entitled to a special commercial law.

Third, the application of the state commercial laws would not frustrate the objectives of Government procurement nor hinder its acquisition of defense interests. Fourth and last, extensive changes in Government procurement operations would not be necessary with the adoption of uniform state law as the federal rule of priority. These principles control in this case and the Court of Claims erred in not following them as prescribed by this Court in Kimbell Foods and correctly applied in Murdock.

The questions presented in this case are ones of first impression for this Court. To correct the misapplication of Kimbell Foods by the Court of Claims and to resolve the conflict of the decision below with the Tenth Circuit's decision in Murdock and for

the reasons already stated, a writ of certiorari should be granted.

Respectfully submitted,

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Certificate of Service

I hereby certify that three copies of the foregoing Petition for Writ of Certiorari and accompanying appendix was mailed first class, postage prepaid to the Solicitor General of the United

States, Department of Justice, Washington, D.C. 20530 this 17th day of December, 1982.

Of Counsel for
Marine Midland Bank